BEFORE THE
UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON ENERGY AND THE ENVIRONMENT

TESTIMONY OF THE HONORABLE RICHARD E. MORGAN
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ON BEHALF OF THE
NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS

ON

"Allocation Policies to Assist Consumers"

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Regulatory Utility Commissioners
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Good morning Chairman Markey, Ranking Member Upton, and Members of the Subcommittee:

My name is Richard E. Morgan, and I am a member of the District of Columbia Public Service Commission. Today I am testifying on behalf of the National Association of Regulatory Utility Commissioners (NARUC). I serve as Leader of NARUC's Task Force on Climate Policy, and I sit on the Association's Board of Directors as well. I am honored to have the opportunity to appear before you this morning and to offer a State regulatory perspective on the crucial issue of consumer protections in the American Clean Energy and Security Act of 2009, particularly as they relate to carbon policies.

NARUC is a quasi-governmental, non-profit organization founded in 1889. Our membership includes the State public utility commissions serving all States and territories. NARUC's mission is to serve the public interest by improving the quality and effectiveness of public utility regulation. Our members regulate the retail rates and services of electric, gas, water, and telephone utilities. We are obligated under the laws of our respective States to ensure the establishment and maintenance of such utility services as may be required by the public convenience and necessity and to ensure that such services are provided under rates and subject to terms and conditions of service that are just, reasonable, and non-discriminatory. As economic regulators, we offer a unique perspective because of our understanding of how climate policy will impact utilities and the consumers we serve.

NARUC is on record as supporting a well-designed economy-wide federal program to limit greenhouse gas emissions[1]. We concluded in 2007 that such action is necessary in order to remove existing uncertainties that are hampering critically needed investment in electricity transmission and generation. NARUC believes that any climate legislation should be transparent, flexible, economy wide, and it should not adversely impact electric and natural gas system reliability or impose undue cost burdens on ratepayers. Furthermore, as the nation transitions to greater reliance upon lower-carbon resources for the generation of electric power, we must consider an expanded role for energy efficiency, alternative and renewable forms of energy, and new energy technologies. In order to keep electricity and natural gas affordable, NARUC believes that it is vitally important to minimize the cost of reducing GHG emissions and the resulting impacts on consumers – many of whom are already struggling to pay their utility bills. In this light, we offer our recommendations regarding the design of a cap-and-trade mechanism and, in particular, how allowances should be allocated within the electric sector.

The distribution of emissions allowances is perhaps the most crucial decision that will need to be resolved in the ACES legislation. Should all allowances be auctioned by the government or should some be given out to certain entities as a means of mitigating economic impacts during a transition period? And, in a related matter, how should the legislation provide for "consumer assistance?"

President Obama has indicated both in his proposed budget and in public statements his support for an immediate, 100% auction of emission allowances. In concept, NARUC supports an auction as the most economically efficient means of distributing allowances. However, we

[1] NARUC Issue Brief on Climate Policy, November 2007

believe that it may be necessary to provide a transitional allocation of free allowances in order to minimize potentially massive economic dislocations as we move toward a 100% auction.

The President and his Administration believe that allocation of allowances to industry at no cost could lead to windfall profits instead of public benefits. As Office of Management and Budget Director Peter Orszag correctly points out, when allowances were given away to European power generators, shareholders – not consumers -- got most the proceeds. It is for precisely this reason that NARUC opposes the allocation of no-cost allowances to electricity *generators*.

State regulators propose a different approach to ease the transition in the electric sector: instead of giving away allowances to power generators, which are often unregulated, give them only to *regulated* local distribution companies (LDCs). Those are the owners of the wires used to distribute electricity, entities that are subject to rate-setting authorities in traditional and restructured jurisdictions alike. State public utility commissions and other authorities (such as consumer-owned utilities), can then ensure that consumers, not utility shareholders, receive the benefits of the free allowances.[2]

Whether regulated utilities use the allowances internally or sell them to generators who need them for compliance, the benefits will go to utility customers. That is because regulators are obligated to account for the receipt of these valuable allowances as income when they set utility

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[2] In this respect, NARUC's position differs from that of the Edison Electric Institute (EEI) and the U.S. Climate Action Partnership (US CAP), as each of those organizations advocates giving some electric sector allowances to unregulated generators.

rates. In fact, State regulators already have in place mechanisms for flowing through the benefits of free emissions allowances from the federal Acid Rain Program implemented in the 1990s.

As utility regulators, we take comfort in President Obama's statement that reducing carbon emissions through a cap-and-trade system must be done in a way that insulates consumers as much as possible from potentially dramatic rate increases that could result. Allocating emissions allowances to LDCs rather than to electricity generators solves the very problem that concerns President Obama and OMB Director Orszag and provides an efficient means of softening the impact on utility consumers.

In effect, the LDC would receive free allowances as a proxy for its customers. Revenues associated with pricing greenhouse gases would be returned to the very consumers who would be at risk for paying higher energy prices. Furthermore, regulators could direct a portion of the proceeds toward mitigating the impacts of pricing carbon, such as through expenditures on energy efficiency or low-income assistance programs. This approach could help to minimize potential economic dislocation for consumers during the transition to a 100% auction, while generation decisions would still be influenced by the full effect of pricing GHG emissions.[3]

How the proceeds of a cap-and-trade mechanism are spent is every bit as important as putting a price on carbon in the first place. By investing in energy efficiency and the development of cleaner energy technologies, we can leverage the funds raised from emitters of greenhouse gases to enhance the impact of pricing carbon. Indeed, some experts warn that

[3] An allocation to LDCs in the electric sector would not preclude allocating allowances to other entities as well, such as to State governments in support of energy programs.

pricing carbon alone is unlikely to achieve the necessary emission reductions.[4] Assuming an allocation to local distribution companies, State regulators can direct the proceeds toward investments that reinforce the goals of limiting GHG emissions and thereby lower the overall cost of achieving emission reductions.

In our view, allocating allowances to regulated LDCs is an elegant solution to the problem of distributing allowances in the electric sector and providing for consumer assistance at the same time

Other ACES provisions

Although this panel is explicitly focused on the question of allowance allocation, I would like to take this opportunity to comment on a few other items in the ACES bill. First, NARUC is pleased to see Rep. Rick Boucher's carbon sequestration proposal included in the ACES legislation. Last year, we worked with the utility industry to reach a compromise on rate-related and governance concerns, and we are happy to see the resulting language included in the discussion draft. As the nation moves closer to limits on GHG emissions, we believe it will be critically important to have generating plants that sequester carbon dioxide as an option in our portfolio of energy resources.

[4] See, for example, Carnegie-Mellon University, Department of Engineering and Public Policy, *Cap and Trade Is Not Enough: Improving U.S. Climate Policy*, March 2009 and Richard Cowart, "Carbon Caps and Energy Efficiency Resources: How Climate Legislation Can Mobilize Efficiency and Lower the Cost of Greenhouse Gas Emission Reduction," *33 Vermont Law Review*, 201-223 (2008).

With regard to energy efficiency, NARUC wishes to indicate its support for Rep. Peter Welch's building-retrofit program, which offers an innovative program for expanding State-based initiatives to rehabilitate buildings to improve efficiency. Rep. Welch's proposal is noteworthy because it provides States with sufficient flexibility to implement such programs, rather than relying upon a federal mandate. This approach recognizes the leadership that States have shown in developing efficiency initiatives that save energy and reduce air emissions. All across the country, from California to Texas to Oregon to Vermont, States are making significant strides in helping their consumers use energy more efficiently. Because each State faces its own individual challenges in implementing energy efficiency measures, NARUC believes that such a "bottoms-up" approach will generally be more effective than a "one-size-fits-all" federal solution.

In a related matter, NARUC raised objections to language in the American Recovery and Reinvestment Act (ARRA) that conditions certain stimulus funds for energy efficiency upon State actions to remove regulatory disincentives toward utility initiatives that boost efficiency. In fact, NARUC has encouraged State commissions to address these regulatory barriers, and an increasing number of States are implementing innovative ratemaking practices such as "decoupling" of utility profits from sales. NARUC nevertheless objected to the funding preconditions in the ARRA, which impose a single, top-down federal solution and fail to recognize the diversity in regulatory structures among the States. In developing the ACES legislation, we urge the committee to acknowledge the inherent diversity and complexity of utility ratemaking and recognize that State regulators are best suited to address such matters. In short, NARUC does not support federally mandated retail-rate design schemes or the conditioning of allowances or auction proceeds upon State implementation of certain regulatory policies.

Another important aspect of any cap-and-trade market will be oversight of the market itself. It should be noted that after the financial sector's recent experience with complicated financial instruments, there is a public expectation for proper and appropriate market oversight.

At this time, NARUC has no position regarding the merits of adopting Renewable Energy Standards or Energy Efficiency Resources Standards at the federal level. We note that many of our member commissions oversee the implementation of such standards at the State level. It is important that federal RES or EERS standards not limit or hinder what States have already accomplished in this area. Design considerations are particularly important for the EERS, where performance is not easily measured. A poorly designed EERS mechanism could result in consumers paying for efficiency that is never delivered. We would welcome the opportunity to work with the Committee and staff regarding these and other provisions in this legislation.

NARUC welcomes the legislation's attention to development of a Smart Grid. We recommend that smart-grid development proceed deliberately and in stages so that the costs of rolling out the necessary infrastructure are borne by those who will benefit and that attention be paid to updating the transmission and distribution system. We view the peak-demand sections of the Smart Grid title as a promising approach to an important issue.

Mr. Chairman and Members of the Subcommittee, NARUC believes that pricing carbon and reducing greenhouse gas emissions are necessary to ensure future energy reliability for our utilities and their consumers. Through the careful design of a cap-and-trade mechanism and an appropriate process for distributing emissions allowances, carbon restrictions can be implemented without undue economic dislocation for consumers. We urge the Committee to recognize the important role that State regulators can play in facilitating the transition to a world of carbon constraints. Thank you for your time and consideration this morning. I would be happy to answer questions at the appropriate time.